INDEX.

TABLE OF AUTHORITIES.

Cases.

Statutes.

Rule.

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. ....

IN THE MATTER OF
VAN SWERINGEN CORPORATION,
Debtor,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,
MELVIN B. HOTT AND ROY BRENHOLTS,
Individually and as Members of said Committee,
and
THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,
Intervening Petitioners,
Petitioners,

vs.

NATIONAL CITY BANK OF CLEVELAND,
Successor Trustee,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondents.

IN PROCEEDINGS FOR THE REORGANIZATION
OF A CORPORATION.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals,
For the Sixth Circuit.

To the Honorable Frederick M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully show:

The petitioners, The Cleveland Hotel Protective Committee, J. C. Lincoln, Gordon Macklin, Robert H. Jamison, Melvin B. Hott and Roy Brenholts, individually and as members of said Committee, and the Henry George School of Social Science, respectfully petition this Honorable Court for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit to review its judgment rendered May 31, 1946, confirming the order of the District Court which confirmed the Cleveland Hotel Reorganization Plan.

I.

STATEMENT OF THE MATTER INVOLVED.

Petitioners are or represent owners of land trust certificates evidencing equitable ownership of the Hotel Cleveland building and site situated on the Public Square in Cleveland, Ohio. Their trustee (The National City Bank of Cleveland as successor-trustee to the Guardian Trust Company, the original trustee), is lessor of the building and site under a 99-year lease made in 1927 to a lessee (The Cleveland Terminals Building Company, a Van Sweringen company), which in 1936, while hopelessly insolvent, filed reorganization proceedings begun under Section 77-B and subsequently continued under Chapter X of the National Bankruptcy Act. Those are the parties to this appeal: the petitioning beneficiaries, the lessee-debtor, and the trustee-lessor.

The petitioners' trustee, as lessor, has a claim against the reorganizing debtor for lease indebtedness. The claim was allowed in these proceedings in the amount of $897,-562.59 as of October 13, 1936, the date the reorganization

petition was filed; and subsequently the claim was allowed in the amount of $1,109,904.31 as of July 1, 1942, the date as of which the confirmed Plan was made effective. This lease indebtedness is partially secured by chattel mortgages, in default, held by the trustee-lessor upon substantially all of the hotel's furniture, furnishings and equipment, the value of such mortgaged chattels having been fixed at $508,473.98 in these proceedings. The remaining part of the trustee's claim against the lessee-debtor, approximating $600,000, is worthless, it being submerged by the debtor's unsecured indebtedness to others in excess of $55,000,000. (R. 728.) The trust's only hope of realizing upon its claim for $1,109,000 is therefore through enforcement of its rights as mortgagee against the $508,000 of mortgaged personal property.

But the Plan denies to the trustee-lessor its right to full priority with respect to these mortgaged assets. Instead, it would transform the trustee-lessor's partially *secured* claim into a completely *unsecured* claim and would give this $508,000 of property back to the debtor, freed of such lease indebtedness, by giving it to a wholly-owned subsidiary of the debtor's. (R. 129.) The Plan provides:

> "Upon the claim of the Trustee for accrued and unpaid rent, and as to which the Trustee duly filed a proof of claim in the 77B proceedings, the Trustee, in respect of the amount for which said claim is finally allowed, shall receive the same relative distribution as general creditors of The Cleveland Terminals Building Company receive on the claims duly proved by them and allowed in said proceedings." (R. 150.)

The Plan provides for the transfer of the insolvent lessee's interest in the hotel property (including the lease) to a new corporation (to be called Cleveland Hotel Corporation). That new corporation is to be endowed at the start with $646,000 of personal property; $508,000 of which is to consist of the property covered by the trustee's chattel

mortgages but discharged of the entire $1,100,000 of lease default; and the other $138,000 is to consist of personal property released for that purpose by the creditors of the present lessee. *But the stock ownership of the new lessee company is not to be divided in proportion to such respective contribution of $508,000 by the trustee and $138,000 by the debtor. Instead, the Plan gives all of such stock to the present insolvent lessee-debtor, and thereby makes a gift to it of the trustee-lessor's $508,000 of mortgaged chattels.*

In addition, the debtor is to reacquire complete management and control of the hotel, upon ending the court-trusteeship under which the Cleveland Hotel has been operated since 1936, through the right to have exclusive voting power of the stock of the operating company (its new subsidiary and the substituted lessee). (R. 145-146.)

In *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 122, the Court reaffirmed the decisions since *Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482, that the creditor must be accorded his full right to priority against the corporate assets where the debtor is insolvent and that participation in a reorganization "must be based on a contribution in money or in money's worth" reasonably equivalent to the participation accorded.

In the Court of Appeals the petitioners urged the applicability of those principles. If the petitioners, through their trustee, had been *only creditors,* perhaps that court might have agreed. However, since petitioners were in addition *also,* through their trustee, in the position of *lessors* to the debtor, that court rejected application of the full priority rule (as to the lessor, and the equivalent contribution rule as to the debtor). Instead of considering the issue to be whether the plan was "fair and equitable" to all those interested, within the pronouncements of the *Los Angeles* case, *supra,* that court considered the issue to be simply one of a lease adjustment and the decisive

question as being only whether the trustee had exercised "sound business judgment" in accepting the proposed modified lease. Speaking through Judge Martin, it said:

> "But, in the circumstances confronted and upon analysis of the approved plan of reorganization of the lessee-debtor corporation, it would seem that *Case v. Los Angeles Lumber Co., supra, and the kindred cases cited above do not point the way to decision in the present controversy.* As stated by the district judge, this 'is not a case of stockholder retention of interest to the detriment of bondholders and creditors'; but our concern is the problem of adjustment of the rights of lessor and lessee under a defaulted lease and the modification of a lease indenture. It is true that the lessor is a creditor—in fact the largest one; but the real issue is whether its best interest would be conserved by acceptance or rejection of the proposed modified lease. The lessor-trustee was vested by the declaration of trust with full authority, in the event of the lessee's default with respect to any of the provisions of the lease, either to terminate the lease or 'to take such other action with respect to the lease or trust estate as it shall deem advisable, without reference to the beneficiaries and as if it were the sole legal and equitable owner thereof.'" (Emphasis ours.)

The Court has held, however, that approval of a plan by various classes concerned is not a substitute for the plan being "fair and equitable" *in fact,* and that "All those interested are entitled to the court's protection." The trustee's opinion should therefore not be decisive. In the opinion in the *Los Angeles* case, 308 U. S., at 114, it was stated:

> "At the outset it should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by Sec. 77B (f) for confirmation of the plan has consented. It is clear from a reading of Sec. 77B (f) that the Congress has required both that the required percentages of each class of security holders approve the plan and

that the plan be found to be 'fair and equitable.' The former is not a substitute for the latter. The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one."

The issues presented to this Court are as to the application of Section 221 of the Chandler Act (11 U. S. C. 621):

(1) Is it essential for the confirmation of the reorganization plan herein that it in fact be "fair and equitable" to all those concerned, including the land trust certificate holders[1]?

(2) If so, is the plan "fair and equitable" within the decisions of this Court when the plan (a) denies the creditor trustee its right of full priority and (b) gives the insolvent debtor a participation in a proportion far beyond its "contribution in money or in money's worth" to the reorganization company which is to take over the property?

(3) Have the land trust certificate holders, as equitable owners, the right to participate in the proceedings?

The trustee bank prepared the plan without any consultation with the land trust certificate holders, its beneficiaries. (R. 508.) It never seriously investigated the possibility of obtaining another lessee. (R. 546-547.) The bank framed the plan—not on the principle of giving its beneficiaries stock proportionate to their contribution to the capital of the new company, but—on the theory of giving the debtor a reward *now* for its operation of the hotel *in*

---

[1] It is stated in the *Los Angeles* case, *supra*, n. 14, at p. 120: "The Chandler Act, c. 10 (52 Stat. 840) approved June 22, 1938, now supplants Sec. 77B. Various substantial changes in the provisions of Sec. 77B have been made therein. But the standard of 'fair and equitable' as used in Sec. 77B remains unaltered as one of the criteria necessary for confirmation of a plan of reorganization. Sec. 221 (2)."

the future. In the trustee's main brief (p. 72) in the Court of Appeals, it candidly admitted:

> "The Trustee did not develop the Hotel Plan on any theory that the Building Company had any equity in the existing lease. The Plan gives recognition to the lessee in the proposed new lease only for long, successful operation of the Cleveland Hotel *in the future.* * * *" (Emphasis ours.)

The Plan (R. 128-151) is dated October 1, 1940, and superseded an abandoned plan dated May 18, 1937. On August 9, 1941, the trustee submitted the plan to the land trust certificate holders and then it began an eleven-months high-pressure campaign to obtain the consent to the plan of 75% of the beneficial interests, as required by the Plan and by the trust indenture. On June 29, 1942, the trustee, ignoring notice from petitioners, who had campaigned in opposition to the Plan, that they had withdrawals of consents (R. 39), determined that it held consents in writing from three-fourths in interest (5,250 interests) of the certificate holders and accepted the plan. Petitioners challenged the effectiveness of that acceptance in the lower courts. However, since the court below held that these were issues of fact and resolved them against petitioners, petitioners do not present such issues here.

The petitioners represent, as owners or as representatives of owners, 1,262 interests out of 7,000 beneficial interests outstanding, or approximately 18%. The two respondents, the trustee and the debtor, in their joint "counter-statement of facts" in the Court of Appeals disputed this and contended (p. 16) that "The representation of the appellants is, therefore, 692 interests at the outside"—which would be approximately 10%. We shall not pause to discuss the point for either way—18% or 10%—petitioners represent a substantial amount which is entitled to protection.

The petitioners, by petition filed in the District Court, sought leave "to intervene herein and to be heard upon all questions pertaining to the Plan of Reorganization as it affects the Cleveland Hotel Building Site." (R. 67) Petitioners, as land trust certificate holders, are outside the benefit of Sec. 206 of the Chandler Act (11 U. S. C. 607) which grants "the *right* to be heard" to "The debtor, the indenture trustees, and any creditor or stockholder of the debtor * * *." Petitioners consequently relied upon Sec. 207 of the Chandler Act, which provides:

> "The judge may for cause shown permit *a party in interest* to intervene generally or with respect to any specified matter."

The District Court refused to permit any of the petitioners to intervene except on the question of the effectiveness of the trustee's acceptance of the plan (90), although none other of the beneficiaries was previously a party and although the trustee, committed from the start to acceptance of the plan, did not and fairly could not represent the viewpoint of the beneficiaries who were opposed to the plan. Consequently, the plan had no official opposition, although the District Court permitted the petitioners, after the record had been made, to argue "the fairness of the plan" "as sort of amicus curiae." (81) The Court of Appeals held that because petitioners had been permitted to argue all matters, "No prejudice to appellants or abuse of discretion by the district court in refusing their petitions for general intervention is apparent."

The District Court confirmed the plan on March 6, 1945, and ordered it put into execution and consummated as of July 1, 1942. (91) On appeal by the petitioners, the Circuit Court of Appeals for the Sixth Circuit, by judgment entered May 31, 1946, affirmed the order of the District Court.

II.

THIS COURT HAS JURISDICTION.

Jurisdiction is invoked under Section 240 of the Judicial Code, 28 U. S. C. 347(a) and Supreme Court Rule 38, par. 5(b).

1.

The case presents a situation where the Circuit Court of Appeals "has decided a federal question in a way probably in conflict with applicable decisions of this Court" (Supreme Court Rule 38, par. 5(b)). In a long line of cases from *Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482, to *Case v. Los Angeles Lumber Co.,* 308 U. S. 106, and *Consolidated Rock Co. v. DuBois,* 312 U. S. 510, the Court has consistently held that creditors are entitled to their full and absolute right of priority against corporate assets; and also, as stated in the *Los Angeles* case (at p. 122), that "where the debtor is insolvent, the stockholder's"—and we submit the debtor's itself—"participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholders." Those principles are embodied in the concept of what is "fair and equitable"; and a finding that a plan is "fair and equitable" is essential under Section 221 of the Chandler Act to its confirmation.

But the Court of Appeals enunciated different principles. It said that "*Case v. Los Angeles Lumber Co., supra,* and the kindred cases cited above do not point the way to decision in the present controversy"; that the problem is (only) one of adjusting a defaulted lease (rather than of fair and equitable treatment of an allowed claim); and that "the real issue" is (only) whether the proposed modified lease is a good one for the lessor. The principle adopted by the court below thus appears to be that the "fair and equitable" requirement of Section 221 applies to defaulted lease indebtedness where the lease is to be

cancelled but does not apply where the lease is to be *continued.* But if the "fair and equitable" rule, and its many carefully worked-out concepts, is to be inapplicable to one type of a continuing situation—a lease, it logically should be inapplicable also in other situations where defaulted obligations are modified and continued, such as mortgages and purchase agreements and options. It is submitted that it is important in reorganization matters to know whether the Court sanctions the inapplicability of the "fair and equitable" requirement of Section 221 to the type of situation here presented as declared by the court below.

2.

It seems to petitioners that the "fair and equitable" requirement, and its associated concepts, either does or does not apply to the type of situation presented. We submit that it does. The court below *said* that the *Los Angeles* case, *supra*, "do not point the way to decision in the present controversy," and nowhere in its opinion did it expressly modify or qualify that statement. However, subsequently, and as if the *Los Angeles* case did, after all, "point the way," it stated that "the trustee under the plan of reorganization of the lessee-debtor receives a fair and equitable consideration for execution of the new lease for the benefit of the beneficiaries of the trust." But while at the same time denying yet giving lip-service to the *Los Angeles* case, that statement, just quoted, does violence to the principles of the *Los Angeles* case and "the kindred cases" which rigidly enforce the full priority rule and the equivalent contribution rule. The items listed by the court as supporting that statement and as constituting "consideration" for the trustee's giving up its $508,000 of property and the insolvent debtor's acquisition of 100% of the stock of the new operating company *"have no place in the asset column of the balance sheet of the new company.* * * * The rigorous standards of the absolute or full priority doc-

trine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds." *Case v. Los Angeles Lumber Co.*, 308 U. S., at 122-123. (Emphasis ours.)

While further analysis of those items will be in our brief, the substance of the plan is that the trustee is to contribute 78% ($508,000) of the capital assets of the new company and the insolvent debtor is to contribute 22% ($138,000), all of which will immediately be property owned by the new operating company. The debtor, through its 100% ownership of the stock of the new company and of the exclusive right to vote it, will have exclusive control and management of the enterprise. The new company will have a reduced fixed rental under the continued lease, with the $1,109,000 of defaulted lease indebtedness forgiven. A constantly increasing major share (from 50% upward) of the net earnings (after payment of the fixed rent) will be used to transfer ownership of the building and site from the beneficiaries to the debtor by being used to buy out, compulsorily, their land trust certificates, by lot. The remaining net earnings, a constantly diminishing minor share (from 50% downward), will be used to pay additional rent proportioned among those trust certificates which survive the draw. Thus will the net earnings be used for the purpose ultimately of making the insolvent debtor, for its contribution of 22% of the capital assets, the owner in fee simple of the entire Hotel Cleveland. The Plan is dressed up with a provision for pledging the stock for a while (without voting power in the pledgee) and for giving the trustee a chattel mortgage again for the *future* lease obligations and for a liquidated damages provision of doubtful validity. The Court of Appeals' statement that "under the plan, none of the trustee's securities passes either to the lessee-debtor or to the unsecured creditors" is inaccurate since the $508,000 of mortgaged property passes immediately to the lessee-debtor's 100% owned new subsidiary,

freed of the defaulted lease claim for which it was mortgaged.

Thus under this ingeniously devised plan, the insolvent debtor's contribution "in money or in money's worth" to "the asset column of the balance sheet of the new company" is 22% of its capital assets. The trust contributes 78% of the capital assets, through the lease of its premises contributes the hotel site and building, and forgives its unsecured claim for $600,000. Equitably, the participation accorded should be 78% of the stock to the trust and no more than 22% to the debtor. Instead, the debtor gets immediate ownership of 100% of the *capital* assets and the benefit of from 50% upward of the *earnings* through their use to buy for the debtor the interests of the beneficiaries in the premises.

Accordingly, when the Court of Appeals stated or determined, whichever is the case, that the items listed by it constituted "a fair and equitable consideration" for the treatment given the beneficiaries by the plan, it misapplied the reorganization law sense of what is "fair and equitable" and thereby "decided a federal question in a way probably in conflict with applicable decisions of this Court." (Supreme Court Rule 38, par. 5(b).)

3.

In this case also the Court of Appeals "has decided an important question of federal law which has not been, but should be, settled by this Court" (Supreme Court Rule 38, par. 5(b)), namely the right of land trust certificate holders to participate in corporate reorganization proceedings. The only determination by the Court of the rights of land trust certificate holders for any purpose that we can find is *Senior v. Braden*, 295 U. S. 422, where it was held that a land trust certificate holder has an equitable interest in the corpus of the trust, and not merely a chose

in action against the trustee. *Cf. Blair v. Commissioner*, 300 U. S. 5, 13.

The instant reorganization plan affected three interests of the land trust certificate holders: (1) *As equitable creditors*, with respect to disposition of the trust's claim for $1,109,000 of lease indebtedness; (2) *as equitable lessors*, with respect to the proposed modifications of the lease of the entire trust corpus, and the provisions enabling the compulsory purchase of beneficial interests by the debtor; and (3) *as beneficiaries*, with respect to the proposed reorganization of the trust indenture.

The court below appears to have taken the position that the certificate holders had no right to be heard in the reorganization proceedings in their capacities (1) as equitable creditors and (2) as equitable lessors, but that the trustee had exclusive right to speak for them therein.[2] In this case the District Court refused to permit any

---

[2] Thus, the Court of Appeals stated (R. 835):

> "It is true that the lessor is a creditor—in fact the largest one; but the real issue is whether its best interest would be conserved by acceptance or rejection of the proposed modified lease. The lessor-trustee was vested by the declaration of trust with full authority, in the event of the lessee's default with respect to any of the provisions of the lease, either to terminate the lease or 'to take such other action with respect to the lease or trust estate as it shall deem advisable, without reference to the beneficiaries and as if it were the sole legal and equitable owner thereof.' The declaration of trust provided further that, by acceptance of any certificate issued under it, the original or any successive holder should be deemed to assent to all provisions contained in the trust agreement."

The court below again indicated adherence to the position that the certificate holders had no right to participate in their capacities as equitable creditors and equitable lessors with respect to the plan, when it stated the issue in terms of the trustee's *discretion*, as follows: "Analyzing the situation confronted by the corporate trustee on July 1, 1942, did it exercise sound business judgment in considering that the terms of the new lease furnished a fair and equitable consideration for its waiver of the security behind approximately $500,000 of the lessor's total back-rent claim?" (R. 838)

land trust certificate holder to become a party to the proceedings, although the property is their investment, but permitted only the insolvent debtor and the trustee to be parties. The Court of Appeals expressly affirmed this, stating "No prejudice to appellants or abuse of discretion by the district court in refusing their (petitioners') petitions for general intervention is apparent." (R. 830)

We submit that the question whether land trust certificate interests—a widely-held form of investment—have any right to be heard in corporate reorganizations, when the trust property is thus disposed of and affected, is an important question of federal law. If the Court of Appeals is correct, it would mean that no reorganization plan involving the interests of the land trust certificate holders would have to be submitted to them except insofar as it might involve a change in the trust indenture. The Court has rendered decisions which define the rights of creditors, mortgagees and stockholders in reorganizations, but none with respect to land trust certificate holders.

III.
THE QUESTIONS PRESENTED.

1. Where the trustee for land trust certificate holders holds as such trustee a secured claim for lease indebtedness against an insolvent debtor-lessee which is in reorganization proceedings under the Chandler Act and the reorganization plan proposes to extinguish such security and to give the security assets to a new company, to be wholly owned by the debtor, which is to become the new lessee under a modified lease, is it necessary to confirmation of the Plan under Section 221 of the Chandler Act that with respect to the land trust certificate holders the Plan be "fair and equitable" as a matter of law?

2. If so, is the plan "fair and equitable" within the decisions of this Court when the plan (a) denies the credi-

tor trustee its right of full priority and (b) gives the insolvent debtor a participation in a proportion far beyond its contribution in money or in money's worth to the reorganization company which is to take over the property?

3. Are the land trust certificate holders entitled to participate in such reorganization proceedings, as parties and otherwise, only with respect to proposed changes in the trust indenture?

IV.

REASONS RELIED UPON FOR ALLOWANCE OF WRIT.

1. The decision of the Circuit Court of Appeals that the equitableness of the plan as to the land trust certificate holders is a matter to be determined by the trustee rather than one for the courts to determine in accordance with the established judicial standards as to what is "fair and equitable," is a decision of a federal question in a way probably in conflict with applicable decisions of this Court.

2. The considerations stated by the Circuit Court of Appeals as justifying the trustee in considering that there was "fair and equitable consideration" for accepting the plan are incompatible with the standards of what is "fair and equitable" in such cases as determined by this Court, and constitutes a decision of a federal question in a way probably in conflict with applicable decisions of this Court.

3. The decision by the Circuit Court of Appeals that it was not an abuse of discretion for the District Court to refuse the petition for intervention of the only land trust certificate holders and Committee who sought to intervene and its decision that the provisions of the trust indenture frustrated any right which the certificate holders might otherwise have under the Chandler Act to participate in the proceedings in what it called "the problem of adjustment,"

is the decision of an important question of federal law which has not been, but should be settled by this Court.

Respectfully submitted,

ROBERT H. JAMISON,
ROBERT F. LEE,
E. D. MCCURDY,
Attorneys for Petitioners.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

THE OPINION BELOW.

The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is reported in 155 F. 2d 1009. The opinion is in the record at page 829.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, 28 U. S. C. 347(a); and under Supreme Court Rule 38, par. 5(b), that the Circuit Court of Appeals has in this case "decided a federal question in a way probably in conflict with applicable decisions of this Court" and that it has "decided an important question of federal law which has not been, but should be, settled by this Court."

Judgment was entered in this case by the United States Circuit Court of Appeals on May 31, 1946. (R. 827.)

STATEMENT OF THE CASE.

The case has already been stated in the preceding petition under Section I thereof, which is hereby adopted and made a part of this brief.

ERRORS RELIED UPON.

The United States Circuit Court of Appeals erred:

1. In ruling that the equitableness or acceptability of the plan as to the land trust certificate holders is a matter to be determined by the trustee rather than one for determination by the courts in accordance with the established judicial standards as to what is "fair and equitable."

2. In failing to require conformation to the established judicial standards as to what is "fair and equitable" in such cases and in applying other standards.

3. In sanctioning the refusal to permit the petitioning land trust certificate holders and their Committee to intervene in the proceedings as parties and in ruling that the certificate holders had no right to participate in what it called "the problem of adjustment."

ARGUMENT.

Point I.

It is essential to confirmation of the plan that it be "fair and equitable" to the land trust certificate holders within the meaning of the Chandler Act, even though integrated into the plan are provisions for lease adjustment.

The Circuit Court of Appeals ruled that "*Case v. Los Angeles Lumber Co., supra* (308 U. S. 106), and kindred cases cited above do not point the way to decision in the present controversy" because "our concern is the problem of adjustment of the rights of lessor and lessee under a defaulted lease" and "the real issue is whether its (the trust's) best interest would be conserved by acceptance or rejection of the proposed modified lease." (R. 835) It then proceeded to test the soundness of the trustee's exercise of discretion, rather than the fairness and equitableness of the plan viewed with reference to compliance with the standards set forth in the *Los Angeles* case. (R. 838)

That was error.

The plan involved disposition of a creditor's claim, of which the land trust certificate holders are the equitable owners, in the amount of $1,109,000 and of property worth $508,000 held as security for that claim. The land trust certificate holders would have been entitled to protection in these proceedings against a disposition of that claim which was not "fair and equitable" as a matter of law if the only issue were the liquidation or disposition of that claim and of the property which secures nearly half of it.

They would be entitled to a judicial determination on the issue of fairness in such a case. And that which it was proposed to give to the trust in substitution for such a secured claim would have to conform as to its *value* to the judicial standards of what is "fair and equitable."

It is submitted that the necessity of such a judicial determination is not dispensed with by the injection into the plan of a proposal to adjust and continue a pre-existing relationship of lessor and lessee. The forum or agency for the protection of the rights of the equitable owners, and the standards applicable thereto, can not be made to depend upon the distinction as to whether the insolvent debtor desires a cancellation or continuation of a pre-existing relationship or obligation, such as in a lease.

We respectfully submit that the *Los Angeles* case and kindred cases *do* "point the way to decision in the present controversy" and that the instant plan must conform, as a matter of law determined by the courts—and not by the trustee—to the standards of what is "fair and equitable" with respect to the land trust certificate holders.

Point II.

The plan is not "fair and equitable" with respect to the land trust certificate holders in that it fails to give the creditor trustee its right of full priority and a participation in the new company equivalent to its contribution thereto.

The plan proposes that the land trust certificate holders, through their trustee, contribute 78% ($508,000) of the capital of the new enterprise and the debtor is to contribute only 22% ($138,000)—yet for this 22% contribution the debtor is to obtain 100% of the ownership of the new enterprise. That clearly is a denial of the creditor trustee's right of full or absolute priority and its right to a participation in the enterprise equivalent and proportionate to its contribution in value thereto. On those facts

the plan unquestionably is as a matter of law not "fair and equitable."

But it is said that the debtor makes other contributions which compensate for this. The only possible contribution of the debtor in addition to the 22% is in the promises of itself *and its new subsidiary* under and with respect to the modified lease. But those promises "have no place in the asset column of the balance sheet of the new company." *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 122-123. Those "contributions" are of the same general nature as were held insufficient for that purpose in the *Los Angeles* case, *supra*, at pp. 122-123, where it was stated:

> "Such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full or absolute priority of *Northern Pacific Ry. Co. v. Boyd*, *supra*, and related cases. Such items, on facts present here, are not adequate consideration for issuance of the stock in question. On the facts of this case they cannot possibly be translated into money's worth reasonably equivalent to the participation accorded the old stockholders. They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities. As such, they cannot be the basis for issuance of stock to otherwise valueless interests. The rigorous standards of the absolute or full priority doctrine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds."

Suppose we examine the "considerations" set forth in the opinion of the Court of Appeals. They are in substance as follows (R. 838-839):

1. The trustee had no assurance that it could obtain as good a lease as that sought by the lessee-debtor.

2. If the trustee had taken over the pledged chattels and cancelled the lease, it would have had to find a new

lessee "adequately financed" and capable of good management, and it might not have fared as well.

3. If a future default by the new lessee occurs, the trustee-lessor would have better security than now.

4. A portion of the net earnings of the new enterprise is to be used to purchase the equitable ownership interests of the land trust certificate holders.

5. None of the trustee's presently owned security "passes" to the debtor or to its unsecured creditors. (It passes to the debtor's new wholly-owned subsidiary.)

6. The assets contributed by the trust (78%) will *again* be security for the (future) obligations of the lease, and in addition the debtor's equity of 22% also will be.

Do those "considerations" meet the test enunciated in the *Los Angeles* case (308 U. S., at 122)—

> "* * * that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder."?

We submit that they do not.

We proceed to examine them, one by one.

1. Clearly, lack of assurance possessed by the trustee that it could obtain as good a lease elsewhere does not constitute a contribution by the debtor to the new enterprise. That is not a "balance sheet" item. It is not a factor equivalent to the 78% contribution by the trust. If the trustee lacked such assurance, it is explainable by the testimony of the officer in charge of the bank department which administers the trust (R. 508) that the bank never seriously investigated the possibility of obtaining "a new lessee" or a lease on better terms (R. 546-547). Nor was it shown to be necessary to make a gift of the $508,000 of property in order to get a lessee.

2. With respect to the suggestion that the trustee might not fare as well if it foreclosed, we quote the Court's answer in the *Los Angeles* case (at pp. 123, 124) to the similar contention made there:

> "The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under Sec. 77B can have no relevant bearing on whether a proposed plan is 'fair and equitable' under that section. * * * To hold that in a Sec. 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders because apart from rehabilitation under that section they would suffer a worse fate, would disregard the standards of 'fair and equitable'; and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation."

Neither does "continuity of management" constitute a justification for giving all of the new stock to the debtor. (*Los Angeles* case, p. 122.)

If the new lessee under the plan is "adequately financed," it is only because 78% of the financing, as a gift, is to come from the trust.

3 and 6. It is said that the certificate holders will have "far better security" if there is a future default by the new lessee (No. 3); and that "additional assets" will be added to the security for future defaults (No. 6).

What are the facts?

There is to be (a) a new chattel mortgage, (b) a liquidated damages provision and (c) a pledge of stock of the new company.

(a) The giving of the new chattel mortgage by the new company adds nothing to the balance sheet of the new company. It will secure only the future (and none of the past) lease indebtedness. The right to the use of the hotel

premises under the lease is a sufficient quid pro quo for obtaining the mortgage in order to secure payment of future rent.

It is said that "The entire existing security of the trustee (worth $508,000) and the additional assets of the lessee ($138,000) become security" under the new chattel mortgage and the stock pledge. But the trust right now is in the position, equitably, of *owner* of 78% of those assets because of the existing lease default. Is it "equitable" to require it to give up *ownership* of 78% in return for getting back a *lien* upon that 78%, plus a lien upon an additional 22%, as security for future indebtedness, when to acquire ownership of that additional 22% presupposes that the trust would incur a future rent loss in an equivalent amount? We submit, not.

(b) Nothing in the plan indicates how the amount of $570,000 used in the liquidated damages provision was arrived at. It simply states: "In the event that the Lease, as modified, is terminated on account of the default of the lessee, the liquidated damages of the Trustee (the lessor) occasioned by such default and termination shall be and are hereby fixed at $570,000" (R. 144). That sum amounts to the total for 3.25 years of the fixed rental of $175,000 per year. It is very questionable that this is a provision for liquidated damages instead of an unenforceable provision for a penalty. It was held in *Miller v. Blockberger*, 111 O. S. 798, that—

> "* * * if there is such discrepancy between the sum stipulated and the damages which would probably and naturally result from the breach as to indicate that the sum stipulated could not have been arrived at by a process of computation and adjustment, or if arrived at by process of computation and adjustment such process did not have for its purpose compensation, but was arrived at for some purpose other than compensation, the sum will be held to be 'penalty' rather than 'liquidated damages.' " (Syllabus 1.)

See, also, *Jones v. Stevens,* 112 O. S. 43; *Norpac Realty Co. v. Schackne,* 107 O. S. 425.

But suppose the "liquidated damages" provision is good for its full amount of $570,000, out of what property would it be collected? It is secured by the same chattel mortgage which is to secure future lease indebtedness—and $508,000 of the property to be subjected to that mortgage equitably belongs to the trustee *right now.* So the result is that if there is deducted from the $646,000 of assets with which the new enterprise is to begin, the $508,000 now belonging to the trust, there is left only the $138,000 being contributed by the debtor. That $138,000 could not possibly be good for payment of the $570,000 of "liquidated damages" even if it was not already security for future unpaid rent which easily could exceed $138,000 in amount. On the basis of the capital assets of the new enterprise at the start, the notion that that amount could ever be collected as liquidated damages is illusory.

(c) With respect to the pledge to the trustee of the stock in the new company (R. 145), the analysis hereinbefore made with respect to the new chattel mortgage applies also to the proposed stock pledge. That stock will be endowed with a book value at the start in the amount of $646,000 (less reorganization expenses), but $508,000 of that value represents property to be contributed by the trust. To get a lien on the other 22% of the value of that stock (to insure payment of rent earned by granting the debtor the use of the hotel premises) is inadequate compensation for giving up the right to own outright 78% of the stock for contributing 78% of the capital on which it is based.

Concluding with respect to Nos. 3 and 6, we respectfully submit that an analysis shows that the "far better security" which the Court of Appeals said the trust would have under the plan is illusory and is not equivalent in value

to the 78% of the capital of the new enterprise which the plan requires the trust to donate to it.

4. Another "consideration" upon which the Court of Appeals relies is the debtor's agreement that a major portion (as it works out) of the net earnings of the new company from operation of the hotel is to be used to buy the beneficiaries' certificates. The result of such use of those net earnings is, if they become of sufficient amount, that the presently insolvent debtor will have built up its 22% contribution to the capital of the operating company into full ownership of the entire Hotel Cleveland site, building and chattels. In the meantime the fixed rent paid by the lessee is reduced each year by a percentage proportionate to the number of certificates so purchased from earnings.

The essence of this provision is that it appropriates for the use and benefit of the debtor the earnings from the 78% portion of the capital of the operating company which is contributed by the trustee. But those contributed assets are trust property, and their fruits equitably belong to the beneficiaries rather than to the debtor. That the debtor promises to use those earnings for the described purpose does not equitably justify diverting them for the benefit of the debtor either to purchase certificates or to purchase any other property desired by the debtor. As the plan works out, the percentage of earnings turned over to the trustee to buy certificates will never amount to as much as 78% of the earnings. It is more equitable and advantageous to the certificate holders that the earnings from their 78% of the capital be turned over to them *as earnings* rather than *as purchase price,* for thereby they not only receive a greater amount but also retain their investment in the trust.

5. The remaining "consideration" set forth in the opinion of the Court of Appeals is its statement, as follows: "It should be observed that, under the plan, none

of the trustee's securities passes either to the lessee-debtor or to the unsecured creditors." This is inaccurate. The trustee's security is its lien upon $508,000 of chattel property which is to be "passed" free of that lien to the lessee-debtor's wholly-owned subsidiary. That *is* the equivalent of "passing" the security to the lessee-debtor itself.

We have analyzed one by one the "considerations" set forth in the opinion of the Court of Appeals as justifying the trustee in considering that there was "a fair and equitable consideration" for the sacrifices sought to be required of the certificate holders. We respectfully submit that both singly and collectively those so-called "considerations" fall far short of compliance with the full priority and equivalent participation requirements of what is "fair and equitable" and, therefore, that the plan in its present form should not have been confirmed.

Point III.

The Circuit Court of Appeals erred in sanctioning the refusal to permit the petitioning land trust certificate holders and their Committee to intervene in the proceedings and in ruling that the certificate holders had no right to participate in what it called "the problem of adjustment."

The Court of Appeals ruled that it was not an "abuse of discretion" for the District Court to refuse to permit any of the petitioners to intervene generally in the reorganization proceedings, although they include the only individual owners and the only Committee who sought to intervene in these proceedings. (R. 830)

The Court of Appeals also took the position that the provisions of the trust indenture as to the powers of the trustee with respect to lease defaults frustrated any right which the certificate holders might otherwise have under the Chandler Act to participate in "the problem of adjustment" which it stated. (R. 835) But the certificate holders

have the largest present interest in the reorganization situation. Unless land trust certificate holders are to become "orphans" in such reorganization proceedings, at least as compared to stockholders and bondholders, certainly they should have the right to participate with respect to all matters which concern them.

We respectfully submit that the Court of Appeals erred in making those rulings.

CONCLUSION.

For the reasons set forth it is respectfully submitted that this case presents important questions of corporate reorganization law which were not decided by the Circuit Court of Appeals in accordance with the Chandler Act and applicable decisions of this Court; and that the case is one calling for the exercise by the Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Robert H. Jamison,
Robert F. Lee,
E. D. McCurdy,
Attorneys for Petitioners.